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**STANDING COMMITTEE ON POVERTY ALLEVIATION**

# EFFECTS ON POVERTY ALLEVIATION OF STRUCTURAL ADJUSTMENT PROGRAMMMES, JOB CREATION POLICIES AND MEANS FOR THE PARTICIPATION OF SMALL SCALE AND MICRO-ENTERPRISES IN INTERNATIONAL TRADE

## STRUCTURAL ADJUSTMENT AND POVERTY ALLEVIATION*

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* The views expressed in this study are those of the author and do not necessarily reflect those of the UNCTAD secretariat.

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## ACRONYMS

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|---|---|
| **EFF** | Extended financial facility |
| **ESAF** | Enhanced structural adjustment facility |
| **IFI** | International financial institution |
| **IMF** | International Monetary Fund |
| **NTB** | Non-tariff barriers |
| **SAF** | Structural adjustment facility |
| **SAP** | Structural adjustment programme |

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## INTRODUCTION

1. The beginning of the 1980s drove home a truth that had been gradually dawning in the 1970s, that the world economy was becoming increasingly unstable. This period saw the second oil shock, an associated recession in the countries of the Organization for Economic Cooperation and Development (OECD), a prolonged slump in real commodity prices, the break-out of the "debt crisis" with all its consequences for developing-country access to world savings, exacerbated by the emergence of the United States of America as a large-scale net borrower, and the erosion through non-tariff barriers (NTBs) of past trade liberalizations.

2. The combined effects of these influences placed the balance of payments of many developing countries under great strain, imposing foreign-exchange constraints. Decisive policy responses became imperative. At the same time the perception spread, especially among OECD donor Governments and the international financial institutions (IFIs), the International Monetary Fund (IMF) and the World Bank, that many past policy interventions in developing countries were aggravating economic problems rather than easing them and that these policies ought to be modified. In response to these forces, the World Bank opened its "structural adjustment" window and the IMF later introduced (or revived, in the case of the extended financial facility) its own structural adjustment facilities (the extended financial facility (EFF), structural adjustment facility (SAF) and enhanced structural adjustment facility (ESAF) ). The 1980s saw a veritable explosion in influence of these adjustment programmes (hereafter called SAPs, for structural adjustment programmes) on policies in developing countries.

3. At the same time - but less in the international limelight - a number of other developing-country Governments, chiefly in East Asia, recognized of their own volition the need to respond to the deteriorating global economic environment and introduced policies which, in some cases, departed rather markedly from the standard IFI model.[1/]

4. It was the IFI-backed programmes which captured most of the attention, however. It soon became apparent that the results of these were, at best, mixed and that the adjustment process was likely to take a good deal longer than the five to ten years that had been expected. It also became apparent that, like short-term stabilization, structural adjustment was by no means painless. There was growing concern that a disproportionate share of the burden was falling on the most vulnerable - a concern culminating in the well-known call by UNICEF for *Adjustment with a Human Face.*[2/]

5. Although the IFIs have since responded to these concerns, many observers doubt whether they have moved far enough to prevent their SAPs from impoverishing the poor. There has, at the same time, been a growing amount of empirical

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1/ See, World Bank, *The East Asian Miracle: Economic Growth and Public Policy,* New York and Oxford: Oxford University Press, 1993.

2/ See, G. A. Cornia, R. Jolly and F. Stewart, (eds) (1987): *Adjustment with a Human Face: Protecting the Vulnerable and Promoting Growth,* Oxford University Press and UNICEF; G. A. Cornia, R.Jolly and F. Stewart, (eds) (1988): *Adjustment with a Human Face: Ten Country Case Studies,* Oxford University Press and UNICEF. See also R. Jolly, "Adjustment with a Human Face: A UNICEF Record and Perspective on the 1980's", *World Development,* 19(12), December 1991.

research into the equity effects of SAPs. The chief purpose of this note is to survey the most recent evidence available and to discuss its policy implications.

6. In examining the effects of adjustment, this note concentrates on the consequences for absolute, as distinct from relative, poverty or the distribution of income (income shares) - an important distinction in countries such as Chile and Mexico, where it appears that adjustment has been associated with both widening inequalities and declining poverty.[3/] This note further concentrates on the effects of medium-to-long-term programmes of structural adjustment, as distinct from short-term stabilization measures of the type supported by IMF stand-by credits, although no sharp distinction is possible and the literature often conflates the two. The coverage, moreover, is confined to effects in developing countries.

7. While it is recognized that global economic conditions and the policies and measures of major industrial countries have a powerful influence on the outcome of the adjustment programmes, including their impact on poverty, a detailed consideration of the external environment falls outside of the remit of this note.[4/] However, this is not to underrate the role of external financing, in particular in support of protecting the poor during adjustment. But besides the possibility of further debt relief, all indicators point towards a continuation of an acute financing constraint. Consequently, the external environment is regarded as given.

8. Part I contains an interpretation of the literature surveyed (largely post-1987). Part II discusses the main policy questions which arise, and part III proposes an agenda of issues for debate by the Standing Committee on Poverty Alleviation.

## I. INTERPRETING THE EVIDENCE

### A. The issues are too complex and opaque to permit simple generalizations

9. Because they comprise interrelated packages of measures, often intended to promote multiple objectives, SAPs demand very good levels of understanding of how each economy works and therefore good-quality, up-to-date statistics. A long-standing concern has, in most cases, been whether the data base is good enough to permit reasonably confident judgements about the ways in which programme measures work themselves out through the economy.

10. The position is especially bad when it comes to gauging the effects of

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3/ According to ECLAC estimates, the proportion of the population living in extreme poverty in Chile fell from 17 per cent in 1987 to 14 per cent in 1990 and to 9 per cent in 1992. Tabatabai and Fouad (1993, p.44) provide figures for the total incidence of poverty rising from 17 per cent to nearly 45 per cent in 1970-1987, then declining to 40 per cent by 1990.

4/ The importance of external factors was underlined by the Intergovernmental Group of Experts on Poverty Alleviation which, in its agreed conclusions, noted that "exacerbating external factors, such as deterioration in terms of trade, external debt burden and reduction of aid flows, do negatively affect development in developing countries and therefore contribute to increasing the number of the poor" (UNCTAD, TD/B/CN.2/8, 2 March 1994). For an account of trends and orientations in providing external resources for poverty alleviation, see UNCTAD, "Mobilization of external resources for poverty alleviation", background note by the UNCTAD secretariat (UNCTAD/PA/4).

SAPs on poverty groups. That requires a good understanding of the nature of poverty in the country in question, of how poverty groups are connected to the remainder of the economy, and of how specific policy measures will affect their welfare. It is clear from the literature surveyed that data of this kind remain deplorably deficient. In fact, absence of reliable data is the single most important reason why the amount of soundly-based quantitative empirical research is still quite limited. Part of the reason, no doubt, is that poverty is an intrinsically difficult topic for government statistical services to come to grips with. In some cases, moreover, the data may remain poor because governments do not choose to give data collection in this area high priority.

11. Additional obstacles to gaining firm knowledge of the effects of SAPs on poverty include:

(a) A large number of influences bear upon the welfare of the poor and it is difficult in practice to disentangle the effects of other factors from those of the policy measures incorporated in a SAP.[5/]

(b) It is difficult to distinguish between the effects of the policies in adjustment programmes and the effects of the additional finance which is attracted in support of SAPs.

(c) There are difficulties in selecting adequate performance indicators in statistically based cross-section analyses, particularly when it comes to trends in poverty.

(d) Some programmes are more fully implemented than others and effectiveness tests should ideally adjust for the degree of implementation.

12. Above all, however, any analysis of SAP effects must take into account the *problem of the counterfactual:* do adjustment programmes result in a poverty situation better than would have obtained without them? Economies are often in crisis immediately prior to adoption of a SAP, so that failure to act could scarcely fail to deepen the poverty problem. It is incorrect to impute to adjustment adverse effects which are more appropriately attributable to the initial crisis.

13. The table attempts to illustrate the potential impact of the measures most commonly incorporated into SAPs which are most likely to impact upon the welfare of poverty groups.[6/] The effects will, however, vary from economy to

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[5/] Kakwani *et al* report an average of 40 policy conditionalities in World Bank SAPs and observe that the linkages between the various policy conditionality and the standard of living "are in some cases positive, in other cases negative, and - most commonly - ambiguous". See N. Kakwani, E. Makonnen and van der Gaag (1990). "Structural Adjustment and Living Conditions in Developing Countries", *PRE Working Paper* No 467, Washington, World Bank, 1990, p.2.

[6/] Note that, for simplification, various groups of economic dependents have been omitted from the table, although in practice the young, the elderly, the disabled and other dependent groups are liable to number among the more vulnerable groups in most societies. Other categories are also commonly employed. One is the "new poor", i.e. those who were previously above the poverty line but who become impoverished as a direct result of adjustment measures, typically as a result of lay-offs in the civil service or in public enterprises.

economy. They are also liable to vary across different groupings of the poor.

14. Import liberalization, for example, is liable to harm the urban working poor by forcing the closure of inefficient local import-substituting industries which can no longer compete, throwing them out of work. Conversely, the urban unemployed could gain through improved availability of imported supplies. The same goes for smallholders growing cash crops, who may benefit from lower prices and more dependable availability of such inputs as fertilisers, insecticides and farm equipment. Smallholders who grow food but still need to buy some of their requirements (food importers) may also gain in theory, through lower prices as a result of import competition. The welfare outcome for smallholders who market a surplus of foodstuffs (exporters) is indeterminate, with both welfare-raising and welfare-reducing influences at work. This is also liable to be the situation with the landless who rely on agricultural employment and non-farm sources of income.

15. Adjustment measures, then, are liable to affect various poverty groups differently and this makes it harder to generalise about overall nets effects. Thus, among smallholders there are liable to be differences in impact upon net food exporters and net importers. No less importantly, there are liable to be major differences in impact as between urban and rural poverty groups, with much of the brunt being borne by the urban poor. Indeed, so strong is this differentiation between rural and urban areas that adjustment has been observed to have significantly narrowed urban-rural inequalities in countries such as Cote d'Ivoire, Ghana, Morocco and United Republic of Tanzania.[7/]

16. Partly as a result of the economic crisis, partly because of other inequalities and structural factors during the 1980s, rural-to-urban migration continued, and with adjustment hitting especially hard the low-income urban groups, absolute poverty in Latin America and the Caribbean changed from being predominantly rural to a situation where a majority of the poor were urban-based (although with large differences among individual countries). While a similar trend was apparent in some African countries, poverty in Africa remained largely rural.[8/]

17. A further factor complicating the analysis concerns the special position of the poorest of the poor. They tend to be economically marginalized. In the rural economy, they come nearest to the classical concept of the subsistence farmer, growing food for family consumption and having only limited connections with the market economy. Weak integration into the market economy is similarly a characteristic of the urban very poor, scratching a living as best they can in the informal, or parallel, economy from activities of sometimes dubious legality. Being marginalized, living in a culture of poverty, these groups are generally left behind in periods of economic expansion. By the same token, they are less at risk from economic downturn and the effects of government policies.

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7/ On the first three countries, see F. Bourguignon and C. Morrisson (1992), *Adjustment and Equity in Developing Countries: A New Approach*, Paris: OECD, and the backing OECD country studies; on United Republic of Tanzania, see H. J. Wagao (1992), "Adjustment Policies in Tanzania, 1981-89: The Impact on Growth, Structure and Human Welfare", in Cornia, van der Hoeven and Mkandawire, *op cit*..

8/ Stewart suggests that about 80 per cent of Africa's poor live in rural communities. F. Stewart, "The Many Faces of Adjustment", *World Development*, 19(12), December, 1991.

Table

Potential impact of selected adjustment measures on various poverty groups

| Adjustment measures | URBAN POOR | | RURAL POOR | | | |
|---|---|---|---|---|---|---|
| | | | Smallholders | | | |
| | Working poor | Unemployed | Cash crop | Food exporters | Food importers | Landless/ working poor |
| Devaluation | N | ? | P | ? | ? | ? |
| Other export promotion | - | P | P | - | - | P |
| Import liberalization | N | P | P | ? | P | ? |
| Government food subsidy reductions | N | N | N | P | N | N |
| Civil service retrenchment | N | - | - | - | - | - |
| Cuts in social services | N | N | N | N | N | N |
| Increased indirect taxes | N | N | N | N | N | N |
| Cost recovery measures | N | N | N | N | N | N |
| Public enterprise reform/ privatization | N | P | P | P | - | - |
| Wage freeze | N | P | - | N | - | ? |
| Credit squeeze | N | ? | - | - | - | - |

*Key:* N = substantial and negative
P = substantial and positive
? = indeterminate
- = no substantial effect

They pay few taxes and enjoy few government services; they have no access to the formal financial system; they are not touched by wage freezes; they have no formal sector jobs to lose; their livelihoods are little affected by the economic cycle or by changing relative prices. In fact, one generalization which seems justified by the evidence is that, in relative terms, it is "the poor", as distinct from "the very poor", who are most at risk in adjustment programmes or, conversely, who stand the best chances of gaining.[9/] This is especially true of the urban poor: as may be seen from the columns of the table, the urban working poor are unique in being affected adversely by every listed policy measure.

18. A further inference that can be derived from the table is that the effects of SAPs are likely to be strongly influenced by the distribution of asset ownership. For example, the outcome in the rural economy depends on whether smallholders participate in cash crop production or mainly estate production. Ghana and Malawi, for instance, represent opposite extremes in this regard. In the forest areas of Ghana, even very poor smallholders commonly grow some cocoa (the principal cash crop) and therefore benefit from the much improved real producer prices resulting from devaluations and other adjustment measures.[10/] In Malawi, on the other hand, smallholders were long forbidden from growing cash crops which compete with the output of estates, such as tea, sugar and flue-cured tobacco.[11/] Ecuador is another country where the agrarian structure channels the benefits of adjustment measures to large landowners.[12/]

19. Another implication of the table is that it is rather rare for a specific instrument to have unambiguous consequences for poverty. Reading across the various entries reveals that most measures stand to harm some groups and benefit others. Often, measures have both income-raising and price-raising effects, giving rise to net benefits or detriments that differ across groups and, being residuals, are difficult to identify. The example of trade liberalization has already been mentioned. On the other hand, cuts in social services, increased indirect taxation and cost recovery measures have uniformly negative predicted consequences. The topic of fiscal policies is discussed further in part II.

20. Given these complexities, it is not surprising (a) that the adjustment-poverty connection has proved very difficult to research conclusively and (b) that studies have tended to find varied results. The evolution of poverty during an adjustment period clearly varies from country to country, and within a given

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9/ Thus, Morrisson's study of adjustment and poverty in Morocco concludes that, overall, adjustment had a beneficial effect on rural poverty but that most of the gains went to the poor, rather than the very poor. C. Morrisson, *Adjustment and Equity in Morocco*, Paris: OECD Development Centre, 1992.

10/ See, A. Roe and H. Schneider with G. Pyatt, (1992), *Adjustment and Equity in Ghana*, Paris: OECD Development Centre.

11/ See, U. Lele, "Structural Adjustment, Agricultural Development and the Poor: Some Lessons of the Malawian Experience", *World Development*, 18(9), September, 1990.

12/ See Bourguignon and Morrisson, 1992, *op.cit.*

country.[13/] Indeed, large amounts of within-country variation considerably reduce the value of cross-country comparisons.

21. Despite such complexities, however, it is possible to suggest a number of additional generalizations which seem reasonably well-founded on the basis of existing knowledge. The following sections examine some of the more important of these.

### B. The poor often are put at risk by the provisions of SAPs

22. The living standards of the poor can be eroded by measures which raise the prices of consumer goods and services. Devaluations have this effect for imported goods. The deregulation of prices is similarly apt to raise living costs (although not uncommonly, the poor already pay market-determined prices on the parallel market, as in the case of potable water, as they do not have access to subsidies). Reductions in government subsidies for food and other items (including cost-recovery measures) obviously tend to hit the real incomes of many of the poor, while they generally secure only a modest, if any, share of the benefits of such subsidies. Increases in indirect taxes, introduced to reduce budget deficits, also tend to be passed on in higher final prices, although the extent to which this affects the poor depends critically on the items on which taxes are increased.

23. Job losses are also a threat. Reductions in civil service over-manning are often included in SAPs (although often poorly implemented). Reduced employment levels are also likely to result from measures to raise the efficiency of public enterprises, or to privatize them. They may also result from lowered levels of protection in local import-substituting industries. People who find their principal source of income destroyed as a result of such unemployment-creating measures are often styled the "new poor", although in some countries they may actually have belonged to the "old poor" because those whose jobs are most often at risk have been paid around or below the relative poverty line. In Chile, for instance, poverty increased in the early 1980s as a result of adjustment-related unemployment, with over half of those thrown out of work coming from the poorest 20 per cent of the population.[14/] No less common is the tendency for real wages to be depressed as a result of SAPs, again hitting the living standards of low-income formal sector workers. It should be noted, however, that the percentage of poor working in civil service jobs remains small in most developing countries. In Peru, for instance, only 3.5 per cent of the labour force are in the bottom three deciles of the income distribution works in the government and parastatal sectors;[15/] in Côte d'Ivoire it is only 1.6 per cent.[16/]

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13/ See, for example, Bourguignon and Morrisson, 1992, *op.cit.* p.48. For similar findings see Kakwani *et al*, *op.cit.* 1990; D. Sahn and A. Sarris, "Structural Adjustment and the Welfare of Rural Smallholders: A Comparative Analysis from Sub-Saharan Africa", *World Bank Economic Review*, 5(2), May, 1991, and Stewart, 1991 *op.cit.*.

14/ See, P. Meller, *Adjustment and Equity in Chile*, Paris: OECD Development Studies Centre, 1992.

15/ See, P. Glewwe and D. de Tray, "The poor in Latin America during adjustment: a case study of Peru", *LSMS Working Paper* No.56, World Bank, Washington, D.C., 1989.

24. One drawback, from the point of view of the poor, is that SAPs are not designed around the principle of minimizing costs and maximizing benefits to the poor. Although awareness of the potentially damaging effects of SAPs has increased, as discussed further on, this awareness has so far had only limited impact on programme design.

25. Thus, while cross-country studies generally show much variation between and within countries, and specific cases can be found where programme measures have had poverty-worsening effects, there appear to be no discernible differences in trends in various poverty indicators between adjusting and non-adjusting countries.[17/] A majority of adjusting countries, however, appear to have experienced worsening conditions in the towns, less so in rural areas.[18/] According to one study of adjustment experiences in Africa, of the 24 countries studied only Mauritius appeared to have simultaneously achieved the objectives of stabilization, structural adjustment, growth and protection of vulnerable groups, while 16 of the countries failed to protect the vulnerable.[19/]

## C. However, the negative effects of adjustment programmes have been commonly exaggerated

26. As shown in the table, adjustment policies by no means need be uniformly adverse to the poor. Devaluation and other export promotion measures could in certain cases help create new employment opportunities and, depending on the ownership of cash crop production, raise the incomes of smallholder farmers. These and other measures also raise the cost of capital relative to labour, thus helping in some degree to generate employment.[20/] Improving the efficiency of state and public enterprise service delivery helps those of the poor who use such services. The same logic applies to reductions in the protection of domestic manufactures.

27. The extent to which outcomes are on balance positive or negative for the poor has to do not only with adjustment but also with the larger policy framework. Informal sector enterprises, moreover, become more competitive with the formal economy as restrictions are removed and the advantages given to formal sector firms are withdrawn. In some countries, e.g. Malawi, clear cases of regressive adjustment can be found, although this appears to be due more to adverse policy and institutional frameworks and uncaring governments than to adjustments *per se*. At the opposite end of the spectrum, countries such as Indonesia and Malaysia provide examples of adjustment accompanied by continued

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16/ See, P. Glewwe and D. de Tray, "The poor during adjustment: A case study of Côte d'Ivoire", *LSMS Working Paper* No.47, World Bank, Washington, D.C., 1988.

17/ See, Kakwani *et al*, 1990, *op.cit.*

18/ See, Stewart, 1991, *op.cit.*

19/ See, A. Cornia, "Is Adjustment Conducive to Long-Term Development? The Case of Africa in the 1980s," *Innocenti Occasional Papers*, Economic Policy Series No. 21, Florence: UNICEF-ICDC, 1991.

20/ Morrisson reports this effect for Morocco. See, Morrisson, 1991, *op.cit.*

reductions in poverty indicators, although in these countries, too, factors outside the adjustment programmes help to explain these outcomes. Chile also provides a favourable, but more complicated example. On the one hand, the adjustment path in the 1980s could be seen as regressive, in that it gave favourable treatment to relatively well-to-do private holders of dollar-denominated debt while reducing welfare payments to large and rising numbers of unemployed.[21/] At the same time, however, the Chilean Government was successful in targeting social spending at the poor, reducing the short-run poverty impact of adjustment, resulting in uninterrupted improvements in such indicators as infant mortality, neonatal mortality and child malnutrition.

28. Other examples of mixed results include Ghana, where some of the poor, especially cocoa-growing smallholders, have gained; food farmers especially in the northern savannah part of the country may have been unaffected; while some of the urban poor have lost, mainly as a result of job losses, others have gained from the new economic opportunities arising from economic recovery. A study of Morocco shows a beneficial effect on rural poverty - although with the poor, as distinct from the very poor, the main beneficiaries - and a worsening for many of the urban poor, especially among those who lost their jobs or whose household head was engaged in the informal sector. In the United Republic of Tanzania, too, adjustment measures have had the effect of narrowing the urban-rural income gap, with the urban poor bearing much of the burden.

29. No simple statement to the effect that "adjustment is good for the poor" or "adjustment further impoverishes the poor" can be sustained by the evidence of the case studies drawn upon above. The complexities and the mixed nature of the results leave a lot of leeway for interpretation. The extent to which adjustment is associated in the minds of observers with a worsening in poverty may be owing to certain selection or presentational biases, motivated sometimes by an advocacy agenda as well as a concern for the welfare of the vulnerable.[22/] Similarly, the theoretic virtues of adjustment to small commodity producers in rural areas is often trumpeted by neo-liberal economists with little regard for empirical evidence, suggesting the complex forces at work in many such environments.

30. Another bias is to attribute to adjustment the deteriorations which have actually been the result of economic crises giving rise to the necessity for adjustment. For example, in reviewing trends in Latin America during the 1980s, several studies point to declines in real wages and consumption standards, and increased proportions of population living in poverty, as evidence of the social costs of adjustment. This, however, overlooks the severe reductions in absorption (consumption and investment) that became *inevitable* after the debt crisis broke in 1982-1983, given Governments' decisions to honour their countries' debt commitments and the policies set forth by creditors. The most that can be said about adjustment policies, on the basis of such evidence, is that they were unable to prevent a poverty deterioration that was inherent in the initial economic situation. In assessing adjustment effects, in short, the counterfactual situation must also be kept in mind.

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21/ See, Meller, 1992, *op.cit.*

22/ Reviewing the watershed UNICEF study, for instance, Preston argued that its authors had given the lion's share of attention to a minority of negative examples and that the country studies actually provide considerably more favourable evidence than the impression conveyed by the synthesis study.

31. Much the same can be said about the situation in Africa. For this region, too, there has been a tendency in the literature to attribute declining real wages and consumption standards during the 1980s to the failings of adjustment; this likewise overlooks the counterfactual. In such cases, the severity of the debt problem and more deep-seated reasons for Africa's economic malaise have been insufficiently attributed.[23/]

32. The widespread belief that adjustment programmes incorporate, or result in, particularly deep cuts in social spending provides another example of the tendency to attribute to SAPs deteriorations which are more due to the initial economic conditions. The empirical literature shows that social spending has actually been one of the more protected categories of expenditure, although there have been serious declines in the *per capita* quantity as well as quality of provision in Africa and Latin America. This deterioration is no doubt largely attributable to the rising claims of interest payments on the public debt and to general conditions of budgetary stringency, rather than to the specific provisions of SAPs *per se*. SAPs, instead, are mainly associated with relative declines in government capital formation, in subsidy expenditures and in military spending. In short, although the evidence is far from definitive, most studies of the issue find *no obvious programme impact on the shares of health and education*, which seem to behave in similar ways in programme and non-programme countries.

33. A further reason for believing that the alleged adverse impact of adjustment measures on the poor is over-exaggerated is that these do not, for the most part, have a direct bearing on the sources of poverty in developing countries. While the sources differ from case to case, they generally include:

(a) Unequal distributions of wealth, with the poor owning little by way of income-generating assets.

(b) Inadequate access to educational and other economic and social services, leaving the poor ill-educated and with few skills.

(c) Largely as a result of (b), the assets of the poor are low in productivity, partly reflecting their unsuitability to the course of modern technologies.

(d) The poor have little market power. This feeds into weak political power, resulting in low priorities for anti-poverty measures, helping to explain (a) and (b) and tending to perpetuate the poverty problem.

(e) A concentration of the un- and under-employed in poverty households, and exceptionally large family sizes, resulting in heavy child dependency, which further tends to perpetuate poverty.

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[23/] See Killick for a review of Africa's post-independence development experience and the factors underlying this. T. Killick (forthcoming), "Explaining Africa's post-independence development experiences", in E. Grilli and D. Salvatore (eds.), *Handbook of Comparative Economic Development*. Westport, CT: Greenwood Publishing. An earlier version was published as Working Paper No. 60 (1992), Overseas Development Institute.

34. Non-income poverty indicators have proved particularly impervious to the influence of adjustment measures. Even during the 1980s, social indicators such as infant mortality, malnutrition and immunizations for Latin America continued to improve despite rising unemployment, declining real wages and shrinking real *per capita* social service provisions. Generally, there were no discernible differences in trends in such indicators between adjusting and non-adjusting countries.[24] To be sure, the relative robustness of indicators with respect to immunization programmes and food security has doubtless been influenced by the activities of aid donors which are unrelated to adjustment. With regard to malnutrition, moreover, even the poor have possibilities for protecting nutrition standards by switching from favoured to less-favoured foods with similar nutritional content, although the greater the poverty the less the possibilities of such substitution.[25]

35. Adjustment measures have probably impacted most on the underlying causes of poverty through their effect on employment, which has generally been negative in the short run. Over-emphasis on such short-term effects may further have contributed to an excessively negative view of the poverty consequences of adjustment. Depending on the nature and magnitude of the initial economic crisis, even the best intentioned governments have found it difficult fully to protect the poor from the adverse short-run effects of measures to reduce absorption, raise international competitiveness and restructure the productive system. The hope, of course, is that strengthened longer-term economic performance will more than compensate for the short-run costs.

36. Chile appears to provide a positive example of this effect. Being one of the first countries to initiate serious structural adjustment policies, overall poverty increased initially. However, the hoped-for economic recovery eventually materialized (aided by renewed inflows of international capital) and the indications are that absolute poverty is now declining rather rapidly in Chile, where the proportion living in extreme poverty apparently nearly halved during the period 1987 to 1992.[26]

### D. Properly conceived, adjustment and structural change are necessary for an effective long-run attack on poverty

37. The term "structural adjustment" came during the 1980s to be closely associated with the policy prescriptions of the IFIs, coming to be seen as the implementation of a package of measures reflecting "the Washington consensus". Structural adjustment needs to be distinguished from the broader concept of structural change: a long tradition in development economics, stemming from the work of Kuznets and Chenery, stresses that structural and institutional transformation is intrinsic to long-run development; within this latter context, structural change is understood as a *permanent* requirement for national economies to adapt to changing circumstances and opportunities.

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[24] See, Kakwani *et al* (1990), *op.cit.*, and E. Zuckerman, "The Social Costs of Adjustment" in Thomas, *et al*, *op. cit.*, 1991.

[25] See, J. Behrman, "The impact of Economic Adjustment Programmes" in D. Bell and M. Reich (eds), *Health, Nutrition and Economic Crises: Approaches to Policy in the Third World*, USA: Auburn House, 1988.

[26] See footnote 3.

38. In this respect, a distinction may be made between structural change which occurs automatically through the market, as the response of economic agents to evolving demands and opportunities, and change that is induced by the manipulation of policy. Although many of the trends and shocks to which economies must respond are autonomous or external, there is, however, much scope for choice and the quality of a government's response can make all the difference between a languishing and a thriving economy. The potency of its choices are all the greater if past policies have retarded the responsiveness of the economy.

39. Structural adjustment and longer-term policies leading to structural change may thus be viewed as a means of keeping abreast of the changing patterns of world demand and competitiveness, technological change and long-run trends in price relativities, as well as to respond to exogenous shocks. With this perspective in mind, it is obvious that no nation can hope to prosper unless it can adapt. In poor countries, economic growth is indispensable if absolute poverty is to be eradicated; thus in such countries adjustment and structural change are essential to long-run poverty-alleviation. Governments which refuse to recognize the need for adjustment measures risk, in the long run, to impose heavy avoidable costs on their inhabitants, not least the poor.

40. For example, when the balance of payments is the chief symptom of structural weakness, a shortage of foreign exchange imposes adjustment: the only real choice is whether it will be controlled or spontaneous adjustment. In the latter case, i.e. in the absence of effective policies, import supplies will dry up, as international creditworthiness is eroded and the availability of foreign exchange diminishes. The economy will be forced to live with whatever volume of imports can be afforded, and "adjustment" will take the form of reduced output, income, employment and living standards. The economic history of Ghana illustrates the adverse consequences of the effective refusal of governments to recognize the need for change, particularly to reverse policies having perverse economic effects.[22]

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[22] The following is quoted from Roe and Schneider, 1992 (*op.cit.*):

*"During most of the two decades prior to 1983 there were declines in production in all sectors. The food self-sufficiency ratio relative to basic consumption requirements declined from 83% in 1964-66 to 71% in 1978-80 and to only 60% in 1982. Production of cocoa, the main cash crop, plummeted from well over 500,000 tons to only about 200,000 tons. Mineral production declined by 46 percentage points between 1975 and 1982, while the index of manufacturing output declined by 50 per cent between 1975 and 1981 alone. The ratio of government revenue to current GDP fell from 16% in 1974-75 to 6% in 1982. Total recurrent and capital expenditure fell from over 27% of GDP in 1975 to 10% in 1983. The monetisation of large budgetary deficits combined with declining production and import capacity generated rapid inflation."*

*"Inevitably, this economic decline worsened poverty. Real per capita incomes fell steadily after 1970. By 1979, real average industrial earnings had fallen to only 30% of the 1970 figure and continued to fall until 1983. While the share of education and health in the budget remained fairly constant, it fell in absolute terms as the budget shrank relative to GDP, so that in 1975-82 alone educational expenditures per capita declined by 70%. Health suffered too, with growing morbidity and mortality. The infant mortality rate went up from around 80 per thousand in the mid-1970s to 110-120 by 1983-84. Nutritional standards declined, with food availability in 1982 30% below the level a decade earlier."*

For further information, see also UNICEF, Accra *(1988)*: "Adjustment

41. An OECD multi-country study, based on models permitting the results of alternative policy stances to be compared with the results of the adjustment measures actually chosen, concluded that:

> "If non-adjustment is defined as a government's refusal to modify its budgetary, monetary or exchange policies - a refusal that compels it, once the possibilities of borrowing abroad have been exhausted, to resort to rationing, beginning with imports - then *all* adjustment policies are, according to our simulations, more efficient (less fall in economic activity) and more equitable (smaller increases in poverty) than not adjusting".

The same study also pointed out that delayed adjustment was considerably less equitable than prompt action because the greater severity and urgency of the initial economic crisis dictated more draconian measures and reduced the scope for protecting the vulnerable.[28]

42. Assuming that adjustment efforts are sustained and successful in restoring economic growth, we can expect the economy-wide benefits of adjustment to have a dominant effect on poverty after the short-term costs have been borne.[29] Indeed, one of the ways in which adjustment policies may harm the poor in the short run is as a result of their overall deflationary effects. Quite apart from its obvious effects on investment, employment opportunities and incomes, growth can benefit the poor by easing the fiscal constraint - broadening the tax base, raising revenues and making it easier for the State to borrow from the populace without crowding out the capital needs of the private sector. Increasing the flow of services to the poor ceases to be a zero-sum game, and thus becomes politically easier.

43. Trickle down effects from growth-generating adjustment, however, are not sufficient. The growth has to take forms that increase the access of the poor to productive assets, such as land and credit, and bring income-raising services such as education, extension services and infrastructure. A special effort has to be made to ensure that the very poor are not left out of general economic expansion, as happens if matters are left to market forces alone.

44. In many respects, the East Asian economies stand as exemplars of pro-poor policies of structural change with little recourse to the assistance of the IFIs, even if caution is necessary about the replicability of certain of their specific

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Policies and Programmes to protect Children and other vulnerable groups in Ghana"; in Cornia *et al, op. cit.; and* N. K. Sowa, "Ghana" in A. Adepoju (ed), *The Impact of Structural Adjustment on the Population of Africa*, London: James Currey, 1993.

[28] See, Bourguignon and Morrisson, 1992, *op.cit.* p.13.

[29] Psachoropoulos *et al*'s study of poverty in Latin America found that absolute poverty rose during recession and fell during economic recovery. A cross-country study by Revallion similarly found that differences in economic growth rates explained about half of variance in poverty incidence between countries. See, G. Psacharopoulos, *et al* (1992), "Poverty and Income Distribution in Latin America: The Story of the 1980's", Latin American and Caribbean Technical Department, Regional Studies Programme, Report No 27, Washington: World Bank, December 1992; M. Revallion (1993), "Growth, inequality and poverty", Washington: World Bank, 1993, p.15.(mimeo).

policy solutions.[30] These are the economies which, despite no less severe terms of trade and other shocks than those felt in other developing countries, were able to turn international trade and technological progress to their advantage, expand exports of manufactures and combine very high and sustained growth rates with macroeconomic stability. These were the flexible economies: adjusting continuously and of their own volition to changing circumstances, diversifying and transforming their productive structures, experimenting with different forms of policy intervention and abandoning those which did not yield the desired results. They were able to achieve these results while reducing inequalities and absolute poverty.[31]

45. Few other adjusting economies have even come close to the results achieved by these countries; falls in capital formation with which IFI SAPs have been associated have actually jeopardized future growth in many countries. The response of low-income economies to adjustment policies, in particular, has been less than robust, especially in sub-Saharan Africa. On the other hand, evidence is beginning to accumulate that middle-income developing countries that have persisted with adjustment policies are now beginning to reap benefits in terms of economic recovery: improvements in some of the previously depressed, heavily-indebted Latin American countries are examples, although these have admittedly been aided by large-scale inflows of capital which may not prove sustainable. How much improvement recovery in these countries may bring to the poor will hinge critically on the adoption of policies in their favour.

46. Whatever the long-term potential, however, the shorter-term reality is that structural adjustment puts poor people at risk. A cost-minimizing approach is needed which is consistent with a long-term strategy for the abolition of absolute poverty.

### E. National Governments have the prime responsibility for protecting the poor during adjustment

47. It would be unnecessary to state such an obvious principle were it not for two factors: the heavy involvement of the IFIs in the design of SAPs; and the often-ignored frequency with which governments do not, in fact, display much concern over the welfare of the poor during adjustment. IFIs will be considered in the next section, while this section will concentrate on the positions of national Governments.

48. Structural adjustment programmes are politically sensitive because of their considerable impact on the distribution of income. While the focus of this paper is on the ways in which they impact upon poverty groups, such programmes are liable to have no less impact on the incomes of some of the richest and most

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[30] The following paragraphs borrow heavily from the account provided by the World Bank, 1993, *op.cit.*, and by A. Chowdhury and I. Islam, *The Newly Industrializing Economies of East Asia*, London: Routledge, 1993.

[31] Percentages of population living below the poverty line:

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|---|---|---|---|---|---|
| Singapore | 1972-82 | first year: | 31 | last year: | 10 |
| Malaysia | 1973-87 | | 37 | | 14 |
| Thailand | 1962-86 | | 59 | | 26 |
| Indonesia | 1972-82 | | 58 | | 17 |

Source: World Bank, 1993, *op.cit.*, table 1.1.

powerful in the land. The existing policies which need reform are not accidental, nor are they the outcome of purely technocratic considerations. They also reflect the distribution of power and influence. For example, the common bias towards urban dwellers - and the difficulty, therefore, of shifting relative prices in favour of agriculture - reflects the greater power and potential for creating trouble of those living in the towns.

49. Policies based on the existing distribution of power therefore often have large inertial force. They cannot easily be changed because those who benefit are influential enough to block reform. Among those potential beneficiaries are the employees of the State - the very ones who must execute policy reforms. Unless treated with care, they can be a potent obstacle to change. As the experience of a number of countries suggests, political opposition can significantly retard progress in the implementation of adjustment programmes.

50. In brief, adjustment is as much a problem of political management as it is of economic design, requiring all the skills and resourcefulness of a country's political leadership. A coalition for reform has to be assembled and nurtured. Precisely how policies are reformed, and the speed and sequencing of the changes, may involve delicate political calculations. Compromises must frequently be struck. There is, as Bourguignon and Morrisson[17] point out, a considerable risk that in this process the interests of the poor will take second place, even when government is sympathetic. There is a frequent tension between the distribution of political power and a desire to protect the poor, who are usually unorganized and rarely powerful.

51. Moreover, by no means are all Governments sympathetic. Addison, for example, suggests in the context of Africa that,

> "... many of the policies that benefit the poor work against the interests of higher-income groups who are politically influential ("vocal") in their demands. These are often the very people who constitute the political power base of the region's governments. Thus governments often direct public expenditures to the benefit of high-income groups, both as government employees and as users of services, rather than to services that are important to poor people such as preventative health care and primary education. ...
>
> "As a result, many governments are reluctant to define a poverty agenda ... in order to avoid sacrificing political patronage. Instead they use rhetoric such as "everyone is poor" to avoid making a political commitment to poverty reduction that would be unpopular with those who keep them in power."[18]

52. At the same time, the incorporation of pro-poor measures in SAPs can actually mobilize political support for the programme, raising its legitimacy and public tolerance of short-term hardships. Bolivia is cited as demonstrating how popular measures to protect the poor can contribute to the sustainability

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[17] Bourguignon and Morrisson, *op.cit.* 1992, p.87.

[18] See, T. Addison, "A Review of the World Bank's Efforts to Assist African Governments in Reducing Poverty", *ESP Discussion Paper* No 10, Washington: World Bank, September, 1993, pages 1 and 2.

of adjustment programmes, with grass-roots organizations participating in a special social fund set up by the State.[34/] However, given its extent, it is important to acknowledge the problem of government indifference and the limitations on what the IFIs can do to design SAPs that will protect the poor in the face of apathy, if not hostility, on the part of the government.

53. There is a further reason for drawing attention to the primary responsibility of the government. This relates to the evidence that the social costs of adjustment are a steeply rising function of delays in embarking upon adjustment measures. This was one of the strongest results of the OECD study, which concludes that:

> ... the only way to avoid the costs of adjustment in crisis is to adjust before a crisis. As the disequilibria are less severe at that time, a smaller reduction in demand is necessary. Consequently, one avoids the sharp rises in unemployment, a swelling of the informal sector and large budget cuts. The greatest advantage of this policy is that it ensures a continuing flow of foreign capital before and during the adjustment period, instead of the complete cessation that occurs when adjustment is postponed until the crisis. This capital flow prevents a fall in private investment and public expenditure, which has socially unfavourable consequences.[35/]

54. The study cites Ghana as a prime example of the heavy costs of delayed adjustment; and Malaysia and Indonesia are among their cases illustrating the benefits of early adjustment.[36/]

55. It must, thus, be a matter for governments to recognize the need for early action. Although they may help at earlier stages, the IFIs only really come into their own when an economic crisis has struck, for it is then that the country's needs for external finance give them maximum policy leverage. Prior to crises, governments may act but, perhaps more often, they may opt instead to wait.

### F. Nevertheless, the IFIs must also share the responsibility in many cases

56. This note began by noting the "veritable explosion" of SAPs in developing countries during the 1980s. This, in combination with the extensive policy conditionality attached by the IMF and World Bank to their adjustment credits, places upon them a responsibility for ensuring that in these programmes the poor are not subjected to needless deprivation and that they share reasonably in any benefits generated. While this must always be principally the responsibility of national governments, the fact that the IFIs consciously seek "a seat at the policy table" and use their financial leverage to influence the policies of governments sometimes in no position to decline their stipulations means that they too have obligations. To be fair, these are obligations which both the IMF

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34/ Zuckerman, 1991, *op.cit.*

35/ Bourguignon and Morrisson, 1992, *op.cit.* pp.13-14.

36/ See, D. Demery and L. Demery, *Adjustment and Equity in Malaysia*, Paris: OECD Development Centre (1992); and E. Thorbecke, *Adjustment and Equity in Indonesia*, Paris: OECD Development Centre, 1992.

and the World Bank now acknowledge.[37] IMF missions now commonly discuss distributional aspects with governments when preparing programmes and there is a requirement that the Policy Framework Papers prepared in connection with SAF/ESAF programmes should "identify measures that can help cushion the possible adverse effects of certain policies on vulnerable groups... in ways consistent with the programme's macroeconomic framework".[38] An increasing number of programmes now contain safety-net provisions, although the chief examples so far have been in the former centrally-planned economies of Eastern Europe.

57. As regards the World Bank, when structural adjustment lending was introduced it was seen as an alternative to the thrust on poverty reduction which marked its policies for most of the 1970s. Noss (1991) has stated in a World Bank *Working Paper* that its early SAPs emphasized relatively short-term macroeconomic policy measures and did not regard them as appropriate instruments for promoting social development; the 1990 *World Development Report*[39] admitted that "when structural adjustment issues came to the fore little attention was paid to the effects on the poor". Like the IMF, the World Bank has also in recent years moved to soften its stance, including the introduction of a special programme of activities known as "Social Dimensions of Adjustment" in 1987 and the creation in 1993 of a vice-presidency with responsibilities in the area of human development and poverty reduction.

58. Two recent events illustrate the changed attitudes of the IFIs. First is the provision in the recently-agreed expansion of the ESAF that programmes should pay greater attention to social safety nets, including contingency provisions.[40] The second development was the announcement by the Managing Director of the Fund, in connection with the devaluation of the CFA franc, that the IMF would agree to budgetary subsidies on some basic foods (or even petrol) as a way of protecting the poor from the price-raising effects of the devaluation.[41]

59. There nevertheless remains room for doubt about the extent to which the changes in message from the top of these agencies has affected actual operations in the field. Scepticism has been expressed about the extent to which sympathetic statements of general intent have influenced detailed programme design.[42] Against such scepticism, the World Bank has reported[43] that the share of adjustment loans that include social-sector conditionality has increased from

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[37] For an account of the factors contributing to the evolution of IMF and World Bank policies in this area, see Jolly, 1991, *op.cit.*

[38] IMF *Annual Report, 1991* pp.51-52.

[39] World Bank, *World Development Report, 1990,* Washington, D.C., p.103.

[40] Reported in *IMF Survey*, 10 January 1994, p.4.

[41] As reported in the *Financial Times*, London, 13 January 1994, p.4.

[42] See, F. Stewart, 1991 (*op.cit.*); and F. Stewart, "Protecting the Poor During Adjustment in Latin America and the Caribbean in the 1980s: How adequate was the World Bank Response?", Centro Studi Luca d'Agliano, *Development Studies Working Paper*, No 44, 1992.

[43] See, World Bank, Implementing the World Bank's Strategy to Reduce Poverty, Washington, D.C., 1993, p.20.

under 5 per cent of all SAPs in 1984 to 1986, to almost 30 per cent in 1990 to 1992. Addison[44] also reports that poverty-related provisions are now more frequently included in programmes, sometimes as preconditions for release of loan tranches. There is no comparable information about the IMF. All in all, it appears that neither institution is yet systematically adopting a cost-minimizing approach to programme design and that there remains considerable scope for improvements from the poverty point of view.

## II. THE POLICY MIX

### A. The need for better information

60. The importance of building a better database is central in the present context. Given all the attention to the poverty problem over the past two decades and the intense interest in the poverty effects of SAPs over the last decade, it is astonishing how little reliable information is available. Much remains to be known about interactions between poverty and adjustment; the limited volume of good country-level research available for this survey reflects the unsatisfactory data situation.

61. Bourguignon and Morrisson make specific suggestions about data priorities:

* Implementation of successive five-yearly household consumption surveys, augmented by annual surveys of a smaller household sample.

* Annual censuses of formal sector enterprises [augmented, we would add, by sample surveys of informal sector enterprises].

* Improvements in the regularity and quality of standard social-indicator statistics, on literacy and education, morbidity and mortality, access to economic, infrastructural and social services, and nutritional status.[45]

62. In addition, the Intergovernmental Group of Experts on Poverty Alleviation agreed that "the development of gender-sensitive indicators, standards and evaluation procedures is important when planning, implementing and monitoring anti-poverty programmes".[46]

63. All this, of course, has to be undertaken in conjunction with a full range of standard economic statistics, in order for researchers to be able to trace the connections between the performance of the national economy, specific policy variables and trends in poverty. The OECD project made a brave beginning but was seriously hamstrung by inadequate data. This is one of the areas where national governments have prime responsibility, but donors can help with resources, as the World Bank is doing in its Social Dimensions of Adjustment project.

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[44] See, T. Addison (1993), *op.cit.*

[45] See, Bourguignon and Morrisson, 1992, *op.cit.*, pp.87-90.

[46] See, the agreed conclusions contained in the report of the Intergovernmental Group of Experts on Poverty Alleviation (UNCTAD, TD/B/CN.2/8).

## B. Principles of policy

64. Assuming now that the problem is sufficiently well understood for effective action to be possible, a number of principles of policy can be suggested.

**Principle 1: MODIFICATIONS TO ADJUSTMENT PROGRAMMES NEED TO BE PUT INTO THE CONTEXT OF A COMPREHENSIVE COUNTRY-LEVEL ANTI-POVERTY STRATEGY**

65. The argument was made earlier that adjustment programmes are only one of many influences on the incidence of poverty, and that the persistence of the poverty problem has its roots in economic and social structures. This not only means that actions to improve the social content of SAPs can make only a very partial contribution to poverty alleviation but also that such actions could be palliative in effect, diverting attention away from the desirability of more fundamental reforms. This point is powerfully reinforced by the conclusion of a recent ILO Working Group report setting out a framework of action against poverty:

> "... action against poverty has been greatly weakened by its fragmented and partial nature. How can wage policy be divorced from employment policy? What sense does it make to treat social security as if it had no relationship to macro-economic policy or the informalization of economic relationships? Each action against poverty faces diminishing returns on its own - but there are substantial complementarities and mutual reinforcements which are possible if an integrated approach is adopted. ..."[47]

66. Although the specifics vary from country to country, a comprehensive anti-poverty strategy is likely to comprehend *sectoral priorities* which favour the poor, e.g. smallholder agriculture and the informal sector; *the structure of asset ownership*, e.g. of land; *factoral priorities* which favour labour-intensity and employment-creation; *improved access* of poverty groups to social and economic services, infrastructure and, above all, education; *fertility restraint*, because of the connections between poverty and family size, and between population growth and unemployment; and *special programmes* in favour of the poorest of the poor wherever they are found, including the landless and female-headed households.[48] While the provisions of SAPs typically impinge upon a number of these dimensions, they certainly do not fully comprehend the relevant range of policies. In this regard, the approach of the World Bank to set its own efforts within country-based Poverty Reduction Strategies is highly

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[47] International Labour Office, "The framework of ILO action against poverty", Geneva, November, 1993, p.53.

[48] Objections may be raised that this paper has been silent on the ways in which SAPs affect the position of women. In fact, a special search was undertaken for materials on this topic but no substantial empirical literature was uncovered. If it is true that the incidence of poverty among female-headed households is greatest in rural areas, whereas poverty in the towns is related more to the low-incomes of male household heads, and if we were correct earlier in suggesting that SAPs tend to shift relative incomes in favour of the rural economy, it seems to follow that such programmes may rather improve initially the relative position of female-headed households below the poverty line.

commendable, if rigorously implemented.[49] Unfortunately, the relationship between these strategy documents and the designs of SAPs remains unclear and apparently weak.[50]

67. In short, the cause of poverty reduction is not best served by excessive concentration on improving the design of SAPs. More positively, measures undertaken to achieve such improvements are likely to be more effective when they are part of a comprehensive strategy that seeks to adapt continuously to changing economic conditions, on the one hand, and to bring about long-term structural change, on the other.

**Principle 2: A BALANCE HAS TO BE STRUCK BETWEEN THE NEEDS FOR ECONOMIC ADAPTATION AND THE DESIRE TO PROTECT THE POOR**

68. This follows from the argument made earlier that, properly understood, adjustment is a necessary condition for an effective long-run attack on poverty. Adjustment, it was suggested, should be understood as flowing from the necessity for any economy to adapt continually to changing economic conditions and shocks.

69. It is widely acknowledged that a proper balance between sound macroeconomic structures and policies is a necessary prerequisite to the success of poverty alleviation programmes.[51]

70. There are a number of trade-offs between adjustment and protection of the poor, at least in the short term. At a general level, concentration on the latter task, for example, may deflect attention away from the tasks of economic adaptation. It is probably true that one of the reasons why the IFIs have moved only slowly in the direction of accepting the desirability of modifying their SAPs to safeguard the interests of the poor has been the fear that governments would seek to use this as a loophole, as an excuse for weaker adjustment policies.

71. More specifically, a necessity to choose arises in the context of attempts to strengthen the macroeconomy by reducing budget deficits. One of the most fully documented consequences of IFI programmes is that these are associated with reductions in public investment and that, when faced with the necessity to cut expenditures, governments commonly cut back on capital formation in preference to current expenditures. Except as a very temporary expedient, cutting infrastructural and other forms of public investment is damaging to the requirements of adjustment, which require more investment rather than less, so as to achieve the necessary economic restructuring. Cutting back on public investment also discourages capital formation by the private sector: there is a good deal of evidence that, at the micro and sectoral levels, the former stimulates ("crowds-in") the latter. (It also creates employment in the construction sector, many of whose recruits are poor.)

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[49] See Addison, 1993, *op.cit.*, pp.19-20. This refers only to the African region and it is not clear whether a similar approach has been adopted for other regions.

[50] See, World Bank, 1993, *op.cit.* p.7, where no clear relationship is described between these two activities.

[51] See, for example, the agreed conclusions in the report of the Intergovernmental Group of Experts on Poverty Alleviation (UNCTAD, TD/B/CN.2/8).

72. However, if public investment expenditures are to be protected in the face of a necessity to cut overall public expenditures, it may often be difficult to avoid deeper cuts in educational, health and other social spending, and/or larger-scale retrenchments in public sector employment. In principle, the trade-off may be evaded by means of improved targeting of social services, or by spending priorities which protect *both* investment and poverty-related spending. Questions relating to the implementation of targeting are taken up below.

73. This dilemma can only be resolved in a specific context. As a general principle, however, overriding priority should be given to safeguarding investment, on the grounds that it is important that economic adaptation should not be impeded, because success in this task may ultimately determine a country's ability to overcome absolute poverty.

74. A trade-off may also arise when the number of public sector workers is excessive. Retrenchment will be desirable for efficiency and macroeconomic management but may throw substantial numbers of employees out of work. It is argued later, however, that the preferable course in such situations is to proceed with the retrenchment, not the least because over-inflated public administrations are detrimental to the low-cost delivery of social and other services benefitting the poor. However, in this case, it will be important to make special provision for those who become unemployed, through retraining schemes and other safety-net provisions.

**Principle 3: ADJUSTMENT POLICIES SHOULD BE DESIGNED SO AS TO MINIMIZE THE COSTS AND MAXIMIZE THE BENEFITS TO THE POOR**

75. The principle of cost minimization is particularly important when it comes to selection of fiscal actions, to be taken up shortly - particularly in the choice of tax measures and in the prioritization of expenditures when it is necessary to cut total non-interest expenditures. Since they take an active interest in these matters, this particularly relates to the policy priorities of the IFIs. It appears that the World Bank now takes a stronger line in defining social priorities in government expenditure programmes and is increasingly making the maintenance of services for the poor the subject of programme conditionality, although we have already noted that these efforts seem not to be closely related to the country poverty strategies which the Bank is also promoting in a number of countries.[52]

76. As suggested earlier, the IMF's position, while an improvement on its earlier stance, remains weak, even though it now takes a more detailed interest in the "quality" of fiscal adjustments, as against its former quantitative emphasis upon reducing the size of the deficit without asking many questions about how that result was to be achieved.[53] From a wider viewpoint, however, the IMF has never been willing to adopt a cost-minimizing approach to the design of its programmes, in the sense of accepting some minimum rate of economic growth, or of social provision, as a constraint upon the design of its programmes. Since government indifference could be an important part of the problem - and since IFIs play a critical role in policy and programme design -

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[52] See Addison, *op.cit.*, 1993, for a balanced and well-informed assessment of the World Bank's current efforts to reduce poverty in Africa.

[53] See, T. Killick, "Continuity and change in IMF programme design, 1982-92", *ODI Working Paper, No.69*, London: Overseas Development Institute, November 1992, pp.19-20.

both the IMF and the World Bank should place more emphasis on the desirability of adopting adjustment programmes which are consistent with properly worked out anti-poverty strategies.

77. At the same time, improvements are not mainly a matter for the IFIs. The case has earlier been argued for treating the design of adjustment as a primary *and continuous* responsibility of governments. Moreover, East Asian and other examples suggest the superiority of results, from the poverty as well as economy-wide viewpoints, of "home-grown" programmes which reflect national priorities rather than IFI policy stipulations.

78. Promoting domestic "ownership" of adjustment and anti-poverty programmes would also give support to "the involvement of the recipients at the design stage. Their participation in the implementation stage and providing them with training are equally important for the success and sustainability of anti-poverty programmes".[54/]

**Principle 4: DEFENDING THE INTERESTS OF THE POOR NECESSITATES EXTENSIVE INTERVENTIONS BY THE STATE**

79. It is now all too often ignored that one of the most serious of all market failures is that an untrammelled market economy tends to give rise to socially unacceptable levels of inequality and poverty. It is extremely difficult to imagine an effective anti-poverty strategy in developing-country conditions which does not necessitate extensive interventions: in the provision of safety nets, of education, extension advice and training, infrastructure and (probably) credit; in reducing inequalities in the ownership of productive assets, e.g. through land reforms; and in ensuring through trade and taxation policies that capital is not subsidized relative to labour. It is no less difficult to see how adjustment processes can be modified to minimize the costs and maximize the advantages to the poor except through the modalities of the State. Various examples of these modalities are given in the next section.

## C. Implementation

### 1. Country specificity

80. Effective anti-poverty measures need to be related to the specific circumstances of each country. The importance of tailoring measures to country conditions is inherent in the evidence offered earlier that the poverty effects of adjustment measures are sensitive to specific economic and social structures, as well as to the nature and severity of the initial condition. Unfortunately, this factor makes it difficult to go beyond general principles into specific recommendations in a general survey of this type.

81. The possibilities of offering useful specific recommendations are further reduced by the view presented earlier of the political nature of the adjustment task, and the desirability of flexibility and compromise in its management. When it comes to the specific measures to be undertaken, the optimal sequencing of these and the best ways of implementing the principles just set out, there is no alternative to a country-by-country approach.

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[54/] Agreed conclusions of the Intergovernmental Group of Experts on Poverty Alleviation (UNCTAD, TD/B/CN.2/8).

2. Integrating SAPs with anti-poverty strategies

82. How SAPs should best be integrated with a country's anti-poverty strategy will depend much upon the institutional specificities of the country in question. The essential point, however, is that the existence of a well worked out anti-poverty strategy will provide the informational base and guiding principles to facilitate the incorporation of positive poverty-alleviation components into a SAP. Having a clear statement of the thrust which anti-poverty measures should have over the longer term, presumably based on a thorough database concerning the nature of poverty in the country in question and how the poor interrelate with the remainder of the economy, should greatly ease the task of designing adjustment programmes intended to minimize the costs and maximize the benefits to the poor.

83. However, for any strategy to remain relevant, it needs to be up-dated from time to time; in this task it is important that the need for adjustment be fed back into the anti-poverty strategy, both as constraining what can be done on the poverty front and as influencing the design and sequencing of anti-poverty actions. In short, there should be a two-way relationship, with the strategy guiding SAP design and with adjustment needs feeding back into periodic modification of the strategy.

3. Positive measures are better than ameliorative responses

84. The task is to design programmes that benefit poor population groups. It is, for example, important to give priority to maintaining infrastructural and other forms of public investment, but particularly those from which poor people can benefit, such as rural feeder roads, health clinics, primary schools and the provision of treated water. Indonesia provides an example here, where investments in rural infrastructure were consciously used to compensate for income losses arising from other adjustment measures.[55/] In addition, infrastructural investments generate employment in the construction sector, which typically employs a large proportion of low-skilled workers.

85. As indicated earlier, export promotion measures, including use of the exchange rate, could contribute to the overall task of adjustment in ways which generate new employment and which, in many cases, raise the incomes of smallholder cash crop producers and farm workers. The reform or (in appropriate circumstances) privatization of relevant public enterprises can contribute both to the overall tasks of structural adjustment and benefit various poverty groups (see the table in part I). This type of action can be important, for example, where statutory agricultural marketing boards operate at low levels of efficiency, having the effect of taxing the farmers forced to sell to them. Addison notes that some of the potential benefit to rural producers of exchange rate, taxation and other reforms is not being passed on because of slowness in reforming systems of agricultural marketing.[56/] Improved delivery of economic and social services by the central government similarly has the virtue of contributing to adjustment and benefitting the poor.

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55/ See, Thorbecke, 1992, *op.cit.*

56/ See Addisson, 1993, *op.cit.*, pp.22-24.

86. There may also be scope for facilitating the integration of the "new poor" - principally those who lose their jobs because of public sector retrenchments - with the development process. A good proportion of those made redundant are likely to be relatively well-educated and capable of running small enterprises. Provision of training, technical support and assistance with start-up capital could be beneficial both for the individuals in question and for the economy.

4. Poverty alleviation packages and social funds

87. However good the intentions, the positive effects of adjustment measures are unlikely to be sufficient safeguards in favour of some vulnerable poverty groups. For these, short-term "safety net" provisions are likely to be essential.[57] In particular, it is important for governments to recognize the special vulnerability to adjustment of the urban poor, as analyzed earlier.

88. One line of approach is the creation of special multi-sectoral "poverty alleviation" packages, along the lines first introduced in Ghana's PAMSCAD (Programme for the Alleviation of the Social Costs of Adjustment) then subsequently introduced in a number of other countries. Such programmes may include projects for: the rehabilitation of schools, clinics and roads; slum upgrading; targeted food programmes; and re-training schemes. Their record has been mixed, however.[58] Their multi-dimensional nature places heavy demands on often weak public administrations; programmes have proved difficult to implement, especially in rural areas. They have not always been successful in reaching many of the poor.

89. As an alternative approach, the creation of special social funds has come into favour, based on an original prototype in Bolivia.[59] These have been used to support labour-intensive infrastructure projects, producer cooperatives and the improvement of nutrition and health services. They differ from PAMSCAD-type programmes, because they are in the form of funds which can respond to local governments, NGOs and other decentralized agencies and, being more demand-driven, should respond more rapidly and flexibly. Probably the boldest such scheme is Mexico's solidarity fund, with a reported budget for 1992 of $2.5 billion. Zambia is another country which has moved in this direction. It is too early to assess the effectiveness of such funds but they nonetheless offer a promising approach, to be monitored carefully.

5. The need for equity in fiscal measures

90. It is useful to recall that in the table (see part I), the poverty effects

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[57] For a fuller discussion on social funds and safety nets, see UNCTAD, "Exchange of experiences on poverty reduction impacts of social funds and safety nets, including mobilization of domestic and external resources for poverty alleviation", issues note by the UNCTAD secretariat (TD/B/CN.2/GE.1/2), and "Recent developments in social funds and safety nets", background note by the UNCTAD secretariat (UNCTAD/PA/2).

[58] C.f. Addison, 1993, *op.cit.*, pp.27-28, and Zuckerman, E. *op.cit.*, 1991.

[59] See, J. Wurgraft, "Social Investment Funds and Economic Restructuring in Latin America", *International Labour Review*, 131(1), 1992; see also Addison, 1993, *op cit.*

of the fiscal measures included were almost wholly negative.[90] This was true, for instance, of the effects of increased indirect taxation - an option included in the table because of the trend in received opinion about tax policy in favour of increasing indirect taxes relative to direct taxation and social security contributions.[91] While indirect taxes are not *necessarily* regressive and can be designed to fall mainly on the consumption expenditures of the relatively well-to-do, if they are also to bring in appreciable revenues it is, in developing-country conditions, difficult to avoid the regressive incidence which is the usual result. In pursuing tax reforms, Governments (and IFIs) therefore need to give very careful consideration to the trade-offs between collection efficiency and equity.

91. The introduction of user charges which more fully reflect the cost of service delivery is in a similar class of actions. In theory, it is possible to design user charges that raise efficiency without adversely affecting the poor,[92] but the reality, in the face of institutional and other constraints, often falls well short of theory. Despite all good intentions to the contrary, higher user-charges often reduce the real incomes of the poor.[93]

92. There is, for example, a strong case for cost recovery in education, because of private rates of return which exceed social returns, and the frequently regressive nature of educational subsidies.[94] However, political and administrative frailties are such that it has sometimes proved difficult to implement cost recovery in education without discouraging the poor from sending their children to the very service which offers the best chance of escape from the culture of poverty. Here again, policy-makers need to think very carefully about the likely distributional consequences of introducing school fees and whether there exists adequate machinery for avoiding deprivation of the poor.

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[90] On the question of the impacts of fiscal measures on the poor, see UNCTAD, "Mobilization of domestic resources for poverty alleviation", background note by the UNCTAD secretariat (UNCTAD/PA/3).

[91] Taking a sample of 39 adjusting countries, Cornia and Stewart found that the revenue-to-GDP ratio rose in 22 countries and fell in 17 from 1980-1987. The most significant changes were a fall in social security contributions and a rise in indirect domestic taxes. Direct taxes as a proportion of the total rose in half and fell in half. See, A. Cornia and F. Stewart, "The Fiscal System, Adjustment and the Poor", Centro Studi Luca d'Agliano, *Development Studies Working Paper*, No.29, 1990.

[92] See, Behrman, *op.cit.*, 1988.

[93] In Ghana, for example, Sowa (*op.cit.*, 1993) reports that hospital fees were introduced in 1985. By 1987 such fees constituted 13 per cent of the recurrent budget of the Ministry of Health. Introduction of fees and charges for drugs has been a disincentive to the use of health services. In some rural areas, outpatient attendance has dropped by nearly 50 per cent. On average, 48 per cent of all sick Ghanaians did not consult a health provider of any kind, according to a 1987-1988 survey.

[94] See, J. Knight, "Educational Policy Issues in a Period of Stabilization and Structural Adjustment", *Journal of Development Planning*, No.19, 1989.

## 6. The advantages and disadvantages of targeting

93. Many of the fiscal choices relate to governments' abilities to *target* charges, subsidies and services accurately, so as to distinguish between poverty groups and others. In the face of demands for State expenditures growing more rapidly than the revenue base, it is difficult to dispute the principle of targeting. Given a financial constraint and much evidence that general subsidies are highly inefficient ways of protecting the poor, with the bulk of subsidies enjoyed by those living above the poverty line, targeting is an appropriate response - if it can be properly implemented.[45]

94. However, there is often a trade-off between the desires to limit claims on government resources and to ensure that all the poor are among those who benefit from the subsidies. A balance, therefore, has to be struck between the objectives of helping the poor and limiting subsidy claims on the fiscal base. As recently argued by Cornia and Stewart[46], universal subsidies are best at reaching all the poor but are wasteful because many of the benefits are enjoyed by the non-poor; narrowly-targeted expenditures cut out much of this waste but generally at the cost of losing coverage of many of the poor (including, probably, a disproportionate share of the very poor).

95. However, at least among the better-endowed developing countries, the practicalities of targeting may be less daunting than is often assumed. In a recent paper based on a survey of the experiences of 30 Latin American countries, Grosh [47] concludes that concern that schemes targeted at the poor will have high administrative costs "is likely to have been greatly over-stated ... a wide variety of programmes have found targeting mechanisms that produce moderately good incidence and that cost very little when measured as a proportion of overall program costs". Targeted schemes, were found to be more progressive than general subsidies - *much* more so in the case of food subsidies and somewhat more in health and education.

96. But what of the case of the poorer developing countries? The same study by Grosh is notably and significantly cautious about the applicability of her results to conditions in sub-Saharan Africa. The danger in countries without the means to administer effectively targeted schemes is that, in the face of tight financial constraints, governments will go through the motions of creating targeted schemes without being able to deliver, leaving many poor people no better off.

97. The dangers are particularly great in the case of food subsidies, even

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[45] In Morocco, for instance, it was found that only 16 per cent of the benefits of general food subsidies were enjoyed by households in the lowest three income deciles (M rrisson, 1992, *op.cit.*).

[46] See, A. Cornia and F. Stewart, "Two errors of targeting", *Journal of International Development*, 5(5), September-October, 1993.

[47] See, M. E. Grosh, "Administrative costs and incidence in targeted programs in Latin America: towards quantifying the tradeoff", Washington, DC, World Bank, 1993, p.20.

though general subsidies may be costly and inefficient. Behrman[46] cites surveys by Pinstrup-Anderson which found that, since food expenditures form 60 to 80 per cent of low-income consumers' expenditures, increases in food prices have a large impact on the poor. While the removal of food subsidies is likely to increase producer prices for farmers, this may not benefit the rural poor as they do not commonly derive a large share of their income from the sale of food. Indeed, many of them are net food purchasers. Pinstrup-Andersen concludes that "food subsidies have increased incomes and improved nutritional status among the poor, particularly, but not exclusively among the urban poor", notwithstanding their inefficiency. This is another policy area in which great care should be exercised.

## III. ISSUES FOR DISCUSSION

98. In conclusion, it may be helpful to identify an agenda of topics which could fruitfully be discussed by representative of developing-country governments and the IFIs. Issues relating to the international economy are left to one side, as falling outside the remit of this paper, although it was earlier made clear that such questions as international contingency financing arrangements and other aspects of the volume of supporting external finance are crucial to any satisfactory overall approach to the alleviation of poverty in adjustment programmes.

99. The following agenda of issues is suggested:

(a) What have proved to be the chief obstacles to the creation of an adequate database on the nature of poverty at the country level? Why has progress in developing databases apparently been so slow in many countries? What are the best ways of accelerating the process and what is the potential role of external technical assistance?

(b) To what extent have poverty reduction strategies been prepared, or are planned? At the country level and within the World Bank, what are seen as the chief difficulties in relating SAP design to country poverty strategies, where these exist? What might be the recommended approach to this issue? Is there a case for creating a new supplementary IFI-based facility for providing additional finance restricted to the support of SAPs which have been explicitly integrated with a publicly stated anti-poverty strategy?

(c) In light of the past association of SAPs with reduced public investment levels, do the IFIs agree with the importance of sustaining this and, if so, what steps have they (particularly the IMF) taken to ensure that this distortion will not continue?

(d) A similar question may be asked about levels of social service provision. Are the IFIs willing to use governments' commitments to maintaining these as a criterion for deciding the desirability of a SAP credit, so as to exclude the worst offenders? How do governments react to this suggestion? More generally, would there be agreement that the IFIs should rule out the possibility of SAP credits in extreme cases of government indifference until government anti-policy policies are strengthened?

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[46] See, Behrman, *op.cit.*, 1988.

(e) What further practical steps would governments and IFIs need to take in order to incorporate into their SAPs the principle of minimizing the incidence of adjustment costs on the poor? What are their attitudes to the relative merits of poverty-alleviation programmes and social funds?

(f) Do country experiences confirm that increased reliance on indirect taxation and the introduction of cost-recovery measures usually has a poverty-increasing effect? If so, how might fiscal requirements best be reconciled with poverty alleviation?

(g) A similar question may be asked about the targeting of government services and subsidies. Does experience confirm that there is a trade-off between limiting claims on revenues and reaching most of the poor? If so, how might this tension be reconciled? Are the favourable findings concerning the feasibility of successful targeting in Latin American countries likely to be replicable in less developed countries?

(h) In connection with the devaluation of the CFA franc, does the recent IMF decision to introduce government subsidies on certain necessities in order to soften the social impact of the devaluation signal a wider relaxation by the IMF on this issue?

(i) What plans have been made by the IFIs for implementation of the stronger emphasis on social measures in the recent agreement to renew and enlarge ESAF?

(j) How can UNCTAD best contribute to the strengthening of poverty alleviation provisions in SAPs?